

SURREBUTTAL TESTIMONY AND EXHIBIT OF
DAVID C. PARCELL
ON BEHALF OF
THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF
DOCKET NO. 2018-319-E
IN RE: APPLICATION OF DUKE ENERGY CAROLINAS, LLC FOR
ADJUSTMENTS IN ELECTRIC RATE SCHEDULES AND TARIFFS AND
REQUEST FOR AN ACCOUNTING ORDER

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is David C. Parcell. I am a Principal and Senior Economist of Technical Associates, Inc. My business address is Suite 130, 1503 Santa Rosa Rd., Richmond, Virginia 23229.

Q. ARE YOU THE SAME DAVID C. PARCELL WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING ON BEHALF OF THE OFFICE OF REGULATORY STAFF (“ORS”)?

A. Yes, I am. I pre-filed direct testimony and two (2) exhibits with the Public Service Commission of South Carolina (“Commission”) on February 26, 2019.

Q. WHAT IS THE PURPOSE OF YOUR PRESENT TESTIMONY?

A. My present testimony is prepared to respond to the Rebuttal Testimonies of Duke Energy Carolinas, LLC (“DEC” or “Company”) witnesses Robert B. Hevert and John L. Sullivan, III.

Q. HOW HAVE YOU ORGANIZED YOUR RESPONSES TO MR. HEVERT'S AND MR. SULLIVAN'S REBUTTAL TESTIMONIES CONCERNING THE COMMON EQUITY COST RATE?

A. Mr. Hevert's Rebuttal Testimony, as it is directed toward my Direct Testimony, addresses the concepts of capital market conditions, DEC and electric utility risks, and various cost of equity models – DCF, CAPM, and CE. Accordingly, my Surrebuttal Testimony addresses each of these concepts in turn. Mr. Sullivan's Rebuttal Testimony responds to my proposal to update DEC's cost of long-term debt. Mr. Sullivan agrees with the concept of updating DEC's cost of debt but proposes an alternative update proposal. I also respond to Mr. Sullivan's proposal. Finally, I respond to the respective Rebuttal Testimonies of Mr. Hevert and Mr. Sullivan that make claims about the financial and rating agency impacts of ORS' rate proposals on DEC.

Q. HAVE YOU PREPARED AN EXHIBIT IN SUPPORT OF YOUR TESTIMONY?

A. Yes, I have prepared one (1) exhibit, identified as Surrebuttal Exhibit DCP-1. This exhibit is comprised of two (2) schedules.

Q. DO YOU HAVE ANY GENERAL COMMENTS CONCERNING MR. HEVERT'S REBUTTAL TESTIMONY?

A. Yes, I do. Mr. Hevert's Rebuttal Testimony, like his Direct Testimony, is biased and focuses only on aspects of cost of capital that favor the Company. In addition, as I note elsewhere, he takes inconsistent positions on issues as he perceives they favor his position. Finally, I point out several instances in which he mis-represents the positions taken in my Direct Testimony.

Q. MR. HEVERT HAS DESCRIBED YOUR RETURN ON EQUITY RECOMMENDATION AS “UNDULY LOW” AND “FAR BELOW THOSE [ROEs] AUTHORIZED FOR OTHER UTILITIES NATIONALLY.” WHAT IS YOUR RESPONSE TO THESE ASSERTIONS?

A. Mr. Hevert has described my return on equity recommendation as “unduly low” (page 2, lines 17-18 of his Rebuttal Testimony) and stated that my recommendation is “far below those authorized for other utilities nationally” (page 7, lines 5-7). However, the reality of the situation is that Mr. Hevert’s recommendation is “unduly high” and is “far above those authorized for other utilities nationally.” This is demonstrated by his own Chart 2 on page 13 of his Rebuttal Testimony, which indicates that for the period he shows, only *one* authorized return on equity is above 10.5 percent and *over* 25 authorized returns on equity are 9.5 percent or less. Clearly this demonstrates that his claim about my testimony is incorrect and the reverse claim applies to his recommendation.

It is also noteworthy that Mr. Hevert’s Chart 2, which purportedly shows how recent commission ROE awards relate to our respective recommendations in this proceeding, shows his ROE range for comparative purposes and only my midpoint ROE. As I noted previously, Mr. Hevert’s Rebuttal Testimony mis-represents my Direct Testimony and focuses only on those aspects that he perceives favor the Company position.

Q. DO ANY OF MR. HEVERT’S POSITIONS TAKEN IN HIS REBUTTAL TESTIMONY CAUSE YOU TO CHANGE YOUR DIRECT TESTIMONY AND RECOMMENDATIONS?

A. No, they do not.

II. CAPITAL MARKET CONDITIONS

Q. ON PAGES 25-27 OF HIS REBUTTAL TESTIMONY, MR. HEVERT DISAGREES WITH YOUR CONCLUSION THAT CAPITAL MARKET CONDITIONS HAVE RESULTED IN A DECLINE IN DEC'S CAPITAL COSTS IN RECENT YEARS. WHAT IS YOUR RESPONSE TO THIS?

A. It is obvious that capital costs have been declining since the Great Recession, as I indicated on pages 14-15 of my Direct Testimony. This is true for DEC both from the standpoint of the Company's cost of debt and cost of equity.

Turning first to DEC's cost of debt, there is no dispute that the *actual* cost of DEC's long-term debt has declined from 5.50 percent in 2014¹ to 4.56 percent currently,² as shown below:

Year	Wgt. Avg. Cost of Debt
2014	5.50%
2015	5.03%
2016	4.74%
2017	4.63%
2018	4.53%

(Sources: 2014-2017 debt costs from response to ORS AIR 2-43; 2018 debt cost from updated response to ORS Rates Request 25-5)

As this indicates, DEC's embedded cost of long-term debt has declined by nearly 100 basis points over the past five years. DEC's last rate proceeding was in 2013, immediately before the period cited above.

In addition, the relative *current* cost of Aa-rated utility debt (*i.e.*, DEC's ratings) has also declined, as shown on my Exhibit DCP-2, Schedule 2, page 2:

¹ Response to DEC ORS AIR 2-43.

² Updated response to ORS Rates Request 25-5.

<u>Year</u>	<u>Yield</u>
2014	4.19%
2015	4.00%
2016	3.73%
2017	3.82%
2018	4.09%
2019 (February)	4.05%

1 Contrary to Mr. Hevert's claims, it is indisputable that the costs of long-term debt, both for
2 DEC's *actual* cost and for Aa-rated utilities' *current* cost, have declined.

3 In addition, contrary to Mr. Hevert assertions on pages 12-13, it is evident that U.S.
4 regulatory commissions have recognized the decline in capital costs by reducing the
5 authorized returns on equity ("ROE") for electric utilities:³

<u>Year</u>	<u>Avg. ROE</u>	<u>Median ROE</u>
2008	10.37%	10.30%
2009	10.52%	10.50%
2010	10.29%	10.26%
2011	10.19%	10.14%
2012	10.02%	10.00%
2013	9.82%	9.82%
2014	9.76%	9.75%
2015	9.60%	9.53%
2016	9.60%	9.60%
2017	9.68%	9.60%
2018	9.58%	9.50%

6 It is inconceivable how Mr. Hevert cannot acknowledge the decline in authorized ROEs
7 since the Great Recession.

8 Even DEC's current filing reflects a reduction in the Company's perceived cost of
9 equity. This is demonstrated by the Company's requested capital costs in its applications
10 for the last rate proceeding (*i.e.*, Docket No. 2013-59-E in 2013) and the current case, as
11 shown below:

³ As shown on page 15 of my Direct Testimony.

<u>Cost of Capital Issue</u>	<u>Docket No. 2013-59-E</u>	<u>Current Case</u>
Common Equity Ratio	53.00%	53.00%
Cost of Long-term Debt	5.28%	4.63%
Return on Equity	11.25%	10.50%

1 It is thus apparent that DEC considers its cost of equity has *declined* from 11.25
2 percent in 2013 to 10.5 percent currently, along with its cost of debt.

3 In addition, it is noteworthy that Mr. Hevert's proposed 10.75 percent ROE has not
4 been adopted by any U.S. state regulatory commission since 2011,⁴ a period of eight years.⁵
5 Mr. Hevert is therefore asking this Commission to allow DEC to charge rates to South
6 Carolina ratepayers that incorporate the highest ROE authorized in the continental U.S.
7 over the past eight years.

8 Finally, as I indicated in my Direct Testimony on page 12 and Schedule 3 of Exhibit
9 DCP-2, recently-authorized ROE's for electric utilities continue to incorporate reduced
10 ROE levels in comparison to previously-authorized ROEs.

11 **III. RELATIVE RISKS OF DEC**

12 **Q. MR. HEVERT MAINTAINS, ON PAGES 27-35 OF HIS REBUTTAL**
13 **TESTIMONY, THAT DEC IS NOT LESS RISKY THAN ELECTRIC UTILITIES**
14 **IN GENERAL. WHAT IS YOUR RESPONSE TO HIS ASSERTIONS?**

15 **A.** Mr. Hevert's contentions are categorically refuted by both rating agencies and
16 security investment services. As I indicated in my Direct Testimony on pages 18-19 and
17 Schedule 7 of Exhibit DCP-2, DEC has been and remains higher-rated, and thus less risky,
18 than electric utilities in general, as well as those utilities in Mr. Hevert's proxy group.
19 DEC's higher security ratings are reflective of less risk for the Company than for the proxy

⁴ Except for a single settled case in Alaska for a remote electric utility. In this proceeding, the Alaska utility requested a ROE of 13.80 percent, which is well above the 10.5 percent requested by DEC in the current case.

⁵ Exhibit No. RBH-6.

companies. One prominent reason for this is the Company's use of multiple regulatory mechanisms, including various accounting deferrals.

Q. DOES MR. HEVERT'S 10.75 PERCENT ROE RECOMMENDATION IMPLICITLY ASSUME THAT DEC IS MORE RISKY THAN OTHER ELECTRIC UTILITIES?

A. Yes, it does. By recommending a ROE that is more than 100 basis points higher than recent ROE awards (*i.e.*, 10.75 percent versus 9.5-9.6 percent over past three years) from other electric utilities, Mr. Hevert presumes that DEC is riskier. However, he has presented no evidence that this is the case. As I indicated above, independent assessments of DEC's risk indicate a consistent demonstration of lower risk.

Q. HAS MR. HEVERT PRESENTED ANY EVIDENCE THAT THE RISKS OF ELECTRIC UTILITIES IN GENERAL AND DEC IN PARTICULAR HAVE INCREASED IN RECENT YEARS?

A. No, he has not. In fact, the risks of electric utilities and DEC have declined over the past five years, which roughly corresponds to the time frame of the Company's last rate proceeding in South Carolina. Schedule 1 of Surrebuttal Exhibit DCP-1 compares several independently derived (*i.e.*, Value Line and Moody's) risk indicators for Duke Energy Corporation (DE), DEC, and the two proxy groups (*i.e.*, Parcell and Hevert) discussed in my Direct Testimony. The following averages of the respective risk indicators are:

Group	Value Line Safety		Value Line Beta		Value Line Financial Str		Moody's Bond Rating	
	2014	2019	2014	2019	2014	2019	2014	2019
Parcell	1.80	1.20	0.72	0.54	A	A+	Baa1/Baa2	Baa1
Hevert	2.30	1.80	0.76	0.60	B++	A	Baa1/Baa2	Baa1
DE	2.00	2.00	0.70	0.50	A	A	Baa2	Baa1
DEC							A1	A1

1 This indicates that both DEC/DE and the two proxy groups have enjoyed
2 improvements in their respective risk assessments since the time of DEC's last rate
3 proceeding in South Carolina.

4 **IV. DISCOUNTED CASH FLOW MODEL (DCF)**

5 **Q. ON PAGES 39-43 OF HIS REBUTTAL TESTIMONY, MR. HEVERT MAINTAINS**
6 **THAT EXCLUSIVE RELIANCE ON ANALYSTS' FORECASTS OF EARNINGS**
7 **PER SHARE IS APPROPRIATE IN A DCF CONTEXT. DO YOU HAVE ANY**
8 **COMMENTS ON THIS?**

9 **A.**Yes, I do. I first note that I do not criticize him for using analysts' forecasts of EPS
10 as one component of growth in his interpretation of the DCF model. In fact, I use EPS
11 forecasts in my DCF analyses as well. What I criticize him for is the *exclusive* reliance on
12 EPS forecasts. As I indicate in my Direct Testimony, investors have a wealth of
13 information available to use in making investment decisions. It is overly simplistic to
14 believe that all investors rely exclusively on EPS forecasts, yet that is what Mr. Hevert is
15 implicitly assuming.

16 **Q. ON PAGE 39, LINES 14-19, MR. HEVERT MAINTAINS THAT "ANALYSTS'**
17 **EARNINGS PROJECTION ARE THE RELEVANT MEASURE OF GROWTH."**
18 **DO YOU AGREE?**

19 **A.**I agree that analysts' projections are "a" relevant measure of growth, but not the
20 "only" relevant measure of growth. If Mr. Hevert were correct, common stock investment
21 would be a very simple exercise and all investors could simply focus on such forecasts in
22 making investment decisions. However, such is not the real world. Different investors

1 have an extensive array of information available to them, only one of which is EPS
2 forecasts. Mr. Hevert paints a very simple picture of a very complex market.

3 **V. CAPITAL ASSET PRICING MODEL (CAPM)**

4 **Q. WHAT IS THE FIRST POINT MR. HEVERT ADDRESSES IN HIS REBUTTAL**
5 **TESTIMONY ON THE CAPM ISSUE?**

6 **A.** Mr. Hevert states his belief, on pages 58-59 of his Rebuttal Testimony, that my use
7 of 20-year U.S. Treasury bonds is improper.

8 **Q. DO YOU HAVE ANY COMMENTS ON HIS POSITION?**

9 **A.** Yes, I do. As I note in my direct testimony, the Duff & Phelps studies, which were
10 used in part to determine my proposed risk premium, use 20-year U.S. Treasury bonds as
11 the measure of “long-term government bonds.” Thus, I am consistent in the use of the term
12 of U.S. Treasury bonds. Mr. Hevert is not. Nor does he acknowledge the use of the 20-
13 year term of the Duff & Phelps studies in his Rebuttal Testimony.

14 **Q. ON PAGES 61-62, OF HIS REBUTTAL TESTIMONY, MR. HEVERT**
15 **MAINTAINS THAT YOUR CAPM ANALYSIS SHOULD HAVE USED**
16 **FORECASTED YIELDS ON U.S. TREASURY BONDS RATHER THAN THE**
17 **CURRENT YIELDS YOU USED. WHAT IS YOUR RESPONSE TO HIS**
18 **ASSERTION?**

19 **A.** I disagree with Mr. Hevert. As I noted in my direct testimony, it is proper to use
20 the current yield as the risk-free rate in a CAPM context. This is the case since the current
21 yield is known and measurable and reflects investors’ collective assessment of all capital
22 market conditions. I note that actual yields, not forecasted yields, are used to determine

the risk premium; thus, it is consistent to apply the risk premium to actual yields rather than forecasted yields.

Q. DO YOU HAVE ANY ADDITIONAL COMMENTS REGARDING MR. HEVERT'S CLAIMS THAT PROJECTED INTEREST RATES SHOULD BE USED AS THE RISK FREE RATE IN A CAPM CONTEXT?

A. Yes, I do. Mr. Hevert claims on page 62 of his Rebuttal Testimony that it is proper to use interest rate forecasts from "Blue Chip." However, it is apparent that, had he proposed such a use of projected rates in prior cases, he would have been incorrect. The table below shows the historic projection of 30-year U.S. Treasury bonds by Blue Chip, as well as the actual yields.

<u>Date of Blue Chip</u>	<u>Forecast Period</u>	<u>Forecast 30-Year T Bonds</u>	<u>Actual 30-Year T Bonds Yield</u>
Nov. 1, 2009	1 Q 2011	5.00%	4.56%
Nov. 1, 2010	1 Q 2012	4.50%	3.14%
Nov. 1, 2011	1 Q 2013	3.80%	3.28%
Nov. 1, 2012	1 Q 2014	3.40%	3.68%
Nov. 1, 2013	1 Q 2015	4.20%	2.55%
Nov. 1, 2014	1 Q 2016	4.10%	2.72%
Nov. 1, 2015	1 Q 2017	3.80%	3.04%
Nov. 1, 2016	1 Q 2018	3.10%	3.03%

This indicates that in seven of the last eight years, forecasts of 30-Year U.S. Treasury bond exceeded the actual levels. In some years, the differential was substantial (*e.g.*, 2010 [1.36 percentage points], 2013 [1.65 percentage points], 2014 [1.38 percentage points], and 2015 [0.76 percentage points]). As a result, any witness or Commission who relied upon forecasted interest rates would have over-estimated the cost of equity.

Q. ON PAGES 64-65 OF HIS REBUTTAL TESTIMONY, MR. HEVERT STATES THAT IT IS IMPROPER TO CONSIDER GEOMETRIC MEAN RETURNS IN THE DETERMINATION OF A RISK PREMIUM AND THAT ONLY ARITHMETIC RETURNS ARE APPROPRIATE. DO YOU AGREE WITH THIS POSITION?

A. No, I do not. What is important is not what Mr. Hevert and I believe, but what investors rely upon in making investment decisions. It is apparent that investors have access to both types of returns (*i.e.*, arithmetic and geometric) when they make investment decisions.

In fact, it is noteworthy that mutual fund investors regularly receive reports on their own funds, as well as prospective funds they are considering investing in, that show geometric returns. Based on this, I find it difficult to accept Mr. Hevert's position that only arithmetic returns are appropriate.

Q. DOES MR. HEVERT USE VALUE LINE INFORMATION IN HIS COST OF CAPITAL ANALYSES?

A. Yes, he does. He has in fact cited Value Line reports on various electric utilities in his Direct and Rebuttal Testimonies.

Q. DO THE VALUE LINE REPORTS SHOW HISTORIC AND PROSPECTIVE GROWTH RATES FOR THE ELECTRIC UTILITIES?

A. Yes, they do.

Q. DO THESE VALUE LINE REPORTS SHOW HISTORIC AND PROSPECTIVE RETURNS ON AN ARITHMETIC BASIS?

A. No, they do not.

Q. DO THE VALUE LINE REPORTS SHOW HISTORIC AND PROSPECTIVE RETURNS ON A GEOMETRIC, OR COMPOUND GROWTH RATE BASIS?

A. Yes, they do. Surrebuttal Exhibit DCP-1, Schedule 2, describes Value Line's method of calculating growth rates. As a result, any investor reviewing Value Line, as Mr. Hevert does, would be using geometric growth rates.

Q. IS IT YOUR POSITION THAT ONLY GEOMETRIC GROWTH RATES SHOULD BE USED?

A. No. I believe that both arithmetic and geometric growth rates should be used as I have done in my Direct Testimony (see pages 39-40). This is the case because investors have access to both and presumably use both.

Q. ON PAGES 62-63, MR. HEVERT ALSO TAKES ISSUE WITH YOUR USE OF ACHIEVED RATES OF RETURN ON BOOK EQUITY IN DERIVING THE EQUITY RISK PREMIUM IN YOUR CAPM ANALYSIS. WHAT IS YOUR RESPONSE TO THIS?

A. I disagree with Mr. Hevert. As I indicate on pages 38-39 in my Direct Testimony, I used measures of both book returns and market returns in developing my CAPM market risk premium components. The rates (*i.e.*, prices) of public utilities are set based upon the book values of their rate base and capital structures, as well as the book levels of expenses and revenues. As such, it is appropriate to consider the level of return on book equity in the determination of the cost of equity (which is applied to the book level of common equity). I also note that the risk premium I derive from my use of book rates of return is the highest of the three risk premiums I considered in my CAPM analyses.

VI. COMPARABLE EARNINGS (CE) METHOD

Q. ON PAGES 77-79 OF HIS REBUTTAL TESTIMONY, MR. HEVERT INDICATES HIS BELIEF THAT YOUR ASSOCIATION OF MARKET-TO-BOOK RATIOS AND RETURNS ON EQUITY IS SUPPORTED BY NEITHER THE ACADEMIC LITERATURE NOR A HISTORICAL ANALYSIS OF THE EXPERIENCE OF NON-PRICE REGULATED COMPANIES. WHAT IS YOUR RESPONSE TO THIS?

A. I disagree with Mr. Hevert. Clearly, public utilities have their rates regulated (*i.e.*, set) based upon their book value of rate base and capital structure. In fact the cost of capital is reflected in the fair return on book value of common equity. Investors are aware of this relationship. Any reference to the experience of unregulated companies, as is evident in Mr. Hevert's Rebuttal Testimony, simply misses the point of public utility regulation.

I further note that Mr. Hevert has mis-represented my testimony on the use of market-to-book ratios ("M/B") in CE context. My CE analyses and conclusions are based upon the actual and projected ROE for the proxy group of electric utilities. I make no adjustment, as Mr. Hevert implies, for the M/B. Rather, I use the M/B as a standard to show that while these companies have earned and are expected to earn these ROEs, their stock price has greatly exceeded 100 percent, which means that their stock market value exceeds the book value upon which their rates are established. I note that in the 1970s and early 1980s, when M/B was less than 100 percent, utilities (including DEC from my personal memory) claimed that this was an indication of existing authorized and earned ROEs being inadequate. They also claimed that they could not issue new shares of common stock without "diluting" the value of existing shares of stock.

Q. ON PAGES 75-76 OF HIS REBUTTAL TESTIMONY, MR. HEVERT STATES THAT THE M/Bs OF THE S&P 500 HAVE BEEN CONSISTENTLY ABOVE 200 PERCENT. IS THIS OBSERVATION RELEVANT FOR PUBLIC UTILITIES?

A. No, it is not. Mr. Hevert's comments apply to the S&P 500, which is predominately made up of unregulated firms. Many unregulated firms, such as energy producing companies and technology-related companies, have book values that do not reflect the actual value of their underlying assets. As a result, the prices they charge their customers are not related to the book value of their assets.

Utilities, in contrast, have their rates established based upon the book values of their assets (*i.e.*, rate base) and liabilities/common equity (*i.e.*, capital structure). As a result, book value is very relevant for public utilities, such as DEC.

I also note that Mr. Hevert is again inconsistent in his Rebuttal Testimony. As noted elsewhere, in criticizing the McKinsey studies, he is eager to claim that their criticisms of analysts' forecasts were "not specific to the utilities industry and therefore data that may not be relevant to the Company" (page 50, lines 6-7). Yet in his own studies he is willing to rely upon an observation of data concerning an unregulated index (*i.e.*, S&P 500) without any regard to whether it is "specific to the utilities industry and therefore data that may not be relevant to the Company."

Q. ON PAGES 80-82 OF HIS REBUTTAL TESTIMONY, MR. HEVERT STATES THAT HE HAS PERFORMED AN ANALYSIS TO DETERMINE THE EXISTENCE OF A DIRECT RELATIONSHIP BETWEEN THE MARKET-TO-BOOK RATIOS OF UNREGULATED COMPANIES AND THEIR EARNED

**RATES OF RETURN ON BOOK COMMON EQUITY. IS HIS STUDY
RELEVANT FOR PUBLIC UTILITIES?**

A. No, it is not. As noted above, Mr. Hevert's study applies to the S&P 500, which is predominately made up of unregulated firms. For the same reasons stated in the previous answer, Mr. Hevert's study is not relevant for DEC.

**Q. ARE THERE ANY INCONSISTENCIES BETWEEN MR. HEVERT'S CRITICISM
OF YOUR REFERENCE TO M/B AND OTHER PARTS OF HIS TESTIMONY?**

A. Yes. Recall that Mr. Hevert claims, in his DCF analyses and Rebuttal Testimony, that EPS is the primary consideration in expected growth rates. This is equivalent to saying that EPS is the primary determinant of stock prices. Yet, he is claiming that ROE and M/B are not related. These are inconsistent positions.

ROE is EPS divided by BVPS (book value per share). M/B is stock price divided by BVPS. Thus, BVPS is a component in both ratios. Logically, and mathematically, if EPS and stock price are related, then ROE and M/B are related. Thus, if EPS drives stock prices, as Mr. Hevert claims in his DCF analyses, then ROE drives M/B.

VI. OTHER HEVERT ISSUES

**Q. HAS MR. HEVERT MADE ANY ADDITIONAL INCORRECT CLAIMS ABOUT
OR MISREPRESENTATIONS OF YOUR TESTIMONY?**

A. Yes, he has. Mr. Hevert has devoted several pages of his Rebuttal Testimony (pages 28-31) to claims that I propose a reduction in DEC's return on equity due to the extensive suite of regulatory mechanisms that the Company has access to. Whereas it is true that I cite the risk-reducing nature of these mechanisms, it is not true that I propose a reduction in DEC's return on equity to reflect their existence. Clearly, as I state on page

24, lines 2-3 of my Direct Testimony, “I recommend that DEC’s return on equity be set at no higher than the mid-point of the cost of equity range for the proxy companies.” The fact that DEC has superior credit ratings, relative to the proxy companies (as I show on page 18, lines 6-10) further indicates that my recommendation is not a reduction relative to the more-risky proxy groups.

In addition, on pages 36-38, Mr. Hevert claims that my proxy group is not as appropriate as his proxy group. This is an unwarranted criticism as my cost of equity analyses are applied to *both* my proxy group and his proxy group. The DCF, CAPM, and CE results for both proxy groups are nearly identical.

VII. RESPONSE TO DEC WITNESS SULLIVAN

Q. DOES MR. SULLIVAN RESPOND TO YOUR PROPOSAL TO UPDATE DEC’S COST OF LONG-TERM DEBT?

A. Yes, he does. I note that DEC’s Application proposed a cost of long-term debt as of December 31, 2017, of 4.63 percent. In my Direct Testimony (page 27, lines 7-11), I indicate that a portion of DEC’s December 31, 2017 long-term debt will mature within the next year and thus is classified as short-term debt (long-term debt due within one year). I thus proposed that the cost of the long-term debt maturing in 2018 be recognized as being re-financed with new long-term debt issues. My proposed cost of long-term debt reflected the re-financing of the retiring issues, which resulted in an updated cost of long-term debt of 4.44 percent.

Mr. Sullivan states that DEC “does not oppose updating the cost of debt.” He proposes an updated cost of 4.53 percent, which reflects the Company’s cost of debt at the

end of 2018 and reflects all of the Company's debt costs at this time, not just the re-financing of the prior year's maturing debt.

Q. WHAT IS YOUR RESPONSE TO MR. SULLIVAN'S PROPOSAL FOR THE UPDATING OF DEC'S COST OF LONG-TERM DEBT?

A. I am not opposed to Mr. Sullivan's proposal. As I indicate above, my proposal does not propose an update of DEC's cost of long-term debt. Rather, I propose to reflect the re-financing of the Company's retiring debt issues.

VIII. DEC'S CLAIMS ON IMPACT OF ORS PROPOSALS

Q. HAVE MR. HEVERT AND MR. SULLIVAN CRITICIZED THE ORS' DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes. Mr. Hevert states in his Rebuttal Testimony (page 34, lines 2-5):

Mr. Parcell's recommendation to *further adjust the company's ROE downward* to account for the Company's Commission-approved deferral accounts unnecessarily penalizes the Company and compounds the financial effect of ORS's recommendation on the Company. [emphasis added]

In addition, Mr. Sullivan claims on page 3, lines 3-5 of his Rebuttal Testimony that there are "detrimental impacts to the Company of Mr. Parcell's recommended 9.3% ROE and the overall revenue requirement proposed by ORS."

Q. DO YOU HAVE ANY COMMENTS ABOUT MR. HEVERT'S CLAIM?

A. Yes, I do. Mr. Hevert's claim is categorically false and totally misrepresents what I stated in my testimony. I clearly state on page 21, lines 4-6:

These mechanisms, on both an independent and collective basis, have the effect of *transferring a portion of DEC's risks from its shareholders to its ratepayers*. This is the case since the risk of fully recovering certain expenses is reduced or eliminated. [emphasis added]

1 This should have been clear to Mr. Hevert that I am talking about the recovery of
2 DEC's expenses (as does ORS witness Zachary Payne), not for an additional recovery of a
3 return on these expenses.

4 Mr. Hevert further misrepresents my testimony when he states that I have
5 "adjusted" the Company's return on equity downward. Again, I clearly state on page 24,
6 lines 1-3:

7 At the very least, the existence of DEC's various existing mechanisms
8 should be recognized in the ROE determination. I recommend that DEC's
9 return on equity be set at no higher than the mid-point of the cost of equity
10 range for the proxy companies.

11 There is no "adjustment" to my return on equity recommendation. I am clearly
12 stating that DEC's return on equity should be the same as the mid-point of the proxy
13 group's return. Had I incorporated an "adjustment," my proposed return on equity would
14 have been less than 9.3 percent. In addition, I have demonstrated that DEC's superior
15 security ratings, relative to those of the proxy groups, could provide justification for an
16 "adjustment" to the Company's return on equity. However, I have made no such
17 adjustment, contrary to Mr. Hevert's misrepresentation of my testimony.

18 I further note that the apparent intent of this portion of Mr. Hevert's Rebuttal
19 Testimony is to imply there is an inconsistency between my testimony and ORS witness
20 Payne's testimony. In fact, there is none. My testimony, as cited above, clearly refers to
21 the recovery of expenses (as does ORS witness Payne) and does not address the
22 appropriateness of further adding a return on these expenses. Nor do I propose an
23 "adjustment" to DEC's return on equity, as Mr. Hevert erroneously claims.

Q. DO YOU HAVE ANY RESPONSE TO MR. HEVERT'S CLAIM THAT DEC SHOULD BE ENTITLED TO A "RETURN" ON CERTAIN OF ITS DEFERRED EXPENSES?

A. Yes, I do. It is my understanding that ORS witness Payne is proposing that DEC should receive a "return of" all of its allowable deferred expenses, and only receive a "return on" its deferred capital expenses. Whereas this is an accounting/revenue requirement issue, I concur with ORS witness Payne that there is no requirement that the Company receive a return on its expenditures that are not related to traditional rate base items. It is my understanding, based on more than 40 years of utility rate case experience, that rate base and operating expenses are treated differently, with only rate base items being eligible for a return.

Q. MR. SULLIVAN PROVIDES A TABLE ON PAGE 6 OF HIS SURREBUTTAL TESTIMONY THAT PURPORTS TO SHOW AUTHORIZED RETURNS ON EQUITY FOR "VERTICALLY INTEGRATED ELECTRIC UTILITIES LOCATED IN THE SOUTHEASTERN UNITED STATES." DO YOU HAVE ANY RESPONSE TO THIS TABLE?

A. Yes, I do. Noticeably absent from this table is Virginia Electric and Power in Virginia⁶ (which is a Southeastern U.S. state). This company, which is perhaps the most closely-related utility to DEC in terms of size and operations, has a currently-authorized return on equity of 9.2 percent.⁷ In addition, Georgia Power has had its return on equity for the purposes of its on-going nuclear construction program riders updated to 10.0

⁶ Mr. Sullivan cites Virginia Electric and Power's ROE in North Carolina (which was a settled ROE) but does not cite the Company's ROE in Virginia (which was a litigated ROE).

⁷ DEC witness Hevert was the cost of capital witness for Virginia Electric and Power Co. in this proceeding.

percent⁸ (which occurred subsequent to its last general rate proceeding), well below the 10.95 percent cited in Mr. Sullivan's table.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

⁸ Value Line Investment Survey, February 17, 2017.

**PROXY COMPANIES
RISK INDICATORS**

Company	Value Line Safety Rank		Value Line Beta		Value Line Financial Strength		Moody's Bond Rating	
	2014	2019	2014	2019	2014	2019	2014	2019
Parcell Proxy Group								
American Electric Power Co.	3	1	0.70	0.55	B++	A+	Baa2	Baa1
Consolidated Edison Co.	1	1	0.65	0.45	A+	A+	Baa1	Baa1
DTE Energy Co.	2	2	0.80	0.55	B++	B++	Baa2	Baa1
Duke Energy Co.	2	2	0.70	0.50	A	A	Baa2	Baa1
Eversource Energy	2	1	0.75	0.60	B++	A	Baa2	Baa1
NextEra Energy, Inc.	2	1	0.75	0.60	A	A+	Baa1	Baa1
Public Service Enterprise Group	1	1	0.80	0.65	A+	A++	nr	Baa1
WEC Energy Group	1	1	0.65	0.50	A	A+	A3	Baa1
Xcel Energy, Inc.	2	1	0.65	0.50	B++	A+	Baa1	A3
Mean	1.8	1.2	0.72	0.54	A	A+	Baa1/Baa2	Baa1
Hevert Proxy Group								
ALLETE	2	2	0.75	0.65	A	A	Baa1	A3
Alliant Energy	2	2	0.75	0.60	A	A	Baa1	Baa1
Ameren Corp	3	1	0.80	0.55	B++	A	Baa3	Baa1
American Electric Power Co.	3	1	0.70	0.55	na	A+	Baa2	Baa1
AVANGRID	na	2	na	0.40	na	B++	Baa1	Baa1
Black Hills Corp	3	2	0.90	0.75	B+	A	Baa2	Baa2
CMS Energy Co.	3	2	0.70	0.55	B+	B++	Baa2	Baa1
DTE Energy Co.	2	2	0.80	0.55	B++	B++	Baa2	Baa1
El Paso Electric	2	2	0.65	0.65	B++	B++	Baa2	Baa1
Hawaiian Electric Industries	2	2	0.80	0.60	B++	A	nr	nr
NextEra Energy, Inc.	2	1	0.75	0.60	A	A+	Baa1	Baa1
NorthWestern Corp	3	2	0.70	0.55	B+	B++	nr	A3
OGE Energy	2	2	0.85	0.85	A	A	Baa1	Baa1
Otter Tail Corp	3	2	0.95	0.75	B+	A	nr	Baa2
Pinnacle West Capital	1	1	0.75	0.55	A	A+	Baa2	A3
PNM Resources	3	3	0.95	0.65	B	B+	Baa3	Baa3
Portland General Electric	2	2	0.75	0.60	B++	B++	Baa1	A3
Southern Company	2	2	0.60	0.50	A	A	nr	Baa2
WEC Energy Group	1	1	0.65	0.50	A	A+	A3	Baa1
Xcel Energy, Inc.	2	1	0.65	0.50	B++	A+	Baa1	A3
Mean	2.3	1.8	0.76	0.60	B++	A	Baa1/Baa2	Baa1

nr - not rated by Moody's this year.

na - not available in Value Line this year.

Sources: Value Line Investment Survey, Standard & Poor's Stock Guide.

HOW TO INVEST IN COMMON STOCKS



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INVESTMENT SURVEY

GLOSSARY

Aaa Corporate Bond Rate—the average yield on corporate bonds rated Aaa by Moody's Investors Service. Bonds that are rated Aaa are judged to be of the best quality.

Accrual Accounting—a method of matching income and expenses in the period they are actually applicable, regardless of the date of collection or payment.

Adjustable-Rate Mortgage Loans (ARMs) (Bank and Thrift Industries)—mortgage loans on which the interest rate charged by the lender is adjusted in accordance with a stipulated, publicly available cost-of-funds index, such as the yield on one-year Treasury bills. (See *Fixed-Rate Mortgage Loans*.)

After market—the market for replacement parts and accessories for a product or group of products. The Auto Parts (Replacement) Industry participates in the automotive after market.

After-Tax Corporate Profits—see *Corporate Profits*.

AFUDC—see *Allowance for Funds Used During Construction*.

Allowance for Funds Used During Construction (Electric Utility Industries)—a non cash credit to income consisting of equity and debt components. This non cash income results from construction work in progress and is expected to be converted into cash income at a future date.

American Depositary Receipts (ADRs)—since most other nations do not allow stock certificates to leave the country, a foreign company will arrange for a trustee (typically a large bank) to issue ADRs (sometimes called American Depositary Shares, or ADSs) representing the actual, or underlying, shares. Each ADR is equivalent to a specified number of shares (the ratio is shown in a footnote on the Value Line page).

American Stock Exchange Composite—a market-capitalization weighted index of the prices of the stocks traded on the American Stock Exchange.

Annual Change D-J Industrials (Investment Companies)—the annual change from year end to year end in the Dow Jones Industrial Average, expressed as a percentage.

Annual Change in Net Asset Value (Investment Companies)—the change in percentage terms of the net asset value per share at the end of any given year from what it was at the end of the preceding year, adjusted for any capital gains distributions made during the year.

Annual Rates of Change (Per Share)—compounded annual rates of change of per-share sales, cash flow, earnings, dividends, and book value (or other industry-specific per-share figures) over the past ten years and five years and estimated over the coming three to five years. All forecasted rates of change are computed from the average figure for the past three-year period to an average for a future three-year period. If data for a three-year base period are not available, a two- or one-year base may be used.

Annual Total Return—the capital gain or loss plus the sum of dividend disbursements expected over the next three to five years, all divided by the recent price and expressed as an average annual rate.

Arbitrage—the simultaneous purchase of an asset in one market and sale of the same asset, or assets equivalent to the asset purchased, in another market. Often referred to as "classical arbitrage," this type of transaction should result in a risk-free profit. Risk Arbitrage refers to transactions in stocks involved in takeover activity.

Arbitrageur—a person or organization that engages in arbitrage activity.

Arithmetic Average—a simple mean. Items to be averaged are added and their sum is divided by the number of items. The result is an arithmetic, or simple, average (or mean).

ARM—see *Adjustable-Rate Mortgage Loans*.